MULTIMEDIA UNIVERSITY

STUDENT ID NO

MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 2, 2015/2016

PPE0045 – PRINCIPLES OF MACROECONOMICS

(Foundation in Management)

5 MARCH 2016
9.00 a.m. – 11.00 a.m.
(2 Hours)

INSTRUCTIONS TO STUDENT

1. This question paper consists of **ELEVEN (11)** pages.
2. Answer **ALL** questions in **Sections A** and **B**.
3. Answer **Section A** in the multiple-choice answer sheet provided and **Section B** in the booklet provided.

SECTION A: MULTIPLE CHOICE QUESTIONS [40 MARKS]

Instructions: Answer **ALL** questions in this section.

1. Which of the following statistics is usually regarded as the best single measure of a society's economic well-being?
   A. the trade deficit
   B. the inflation rate
   C. the unemployment rate
   D. gross domestic product

2. Because every transaction has a buyer and a seller, _____.
   A. firms' profits are necessarily zero in a simple circular-flow diagram.
   B. every transaction contributes equally to an economy's income and to its expenditure.
   C. GDP is more closely associated with a nation's income than it is with a nation's expenditure.
   D. the number of firms must be equal to the number of households in a simple circular-flow diagram.

3. A country reported a nominal GDP of $85 billion in 2005 and $100 billion in 2004; it reported a GDP deflator of 100 in 2005 and 105 in 2004. Between 2004 and 2005, _____.
   A. real output and the price level both rose.
   B. real output rose and the price level fell.
   C. real output fell and the price level rose.
   D. real output and the price level both fell.

4. A decrease in the price level results in a(n) _____ in household consumption spending and a(n) _____ in investment spending.
   A. increase; increase
   B. decrease; increase
   C. increase; decrease
   D. decrease; decrease

5. When a family's income is low and it is spending more on consumption than it is receiving in income, _____.
   A. the APC must be increasing
   B. the APC must be equal to the ratio of consumption expenditure to total saving.
   C. the MPC must be zero
   D. some segment of the consumption function curve lies above the 45-degree line, indicating dissaving

Continued...

6. If the MPC is 0.75 and government purchases increase by RM200 billion, then _____.
   A. equilibrium level of national income will increase by RM50 billion
   B. equilibrium level of national income will increase by RM800 billion
   C. equilibrium level of national income will increase by RM200 billion
   D. the effect on equilibrium level of national income cannot be determined from the given information

7. Which of the following fiscal policy actions would be appropriate if the economy is experiencing an inflationary gap?
   A. An increase in taxes
   B. A decrease in interest rates
   C. An increase in the money supply
   D. An increase in government spending

8. The smaller the slope of the aggregate expenditure (AE) curve, the _____.
   A. larger are imports
   B. larger the expenditure multiplier
   C. smaller the expenditure multiplier
   D. larger is the marginal propensity to save

9. Keeping RM50 in currency to be able to buy petrol, money is performing which function?
   A. Store of value.
   B. Unit of account.
   C. Barter mechanism.
   D. Medium of exchange.

10. Which statement most accurately captures the state of money today?
    A. Money today includes currency, bank deposits and cheques.
    B. Money today includes currency and cheques but not bank deposits.
    C. Money today includes bank deposits and currency but not cheques.
    D. Money today includes bank deposits and cheques but not currency.

11. When Maria deposits RM100 in currency in her checkable deposit at Maybank, the immediate effect is that the quantity of M1 money supply _____.
    A. increases
    B. decreases
    C. does not change
    D. changes only if Maybank does not have excess reserves

12. Bank Negara Malaysia is a central bank and as such it _____.
    A. does business only with the federal government
    B. provides banking services to banks but not individuals
    C. is where the federal government turns when it needs to borrow
    D. does business with international organisations such as the United Nations

Continued...

13. If the required reserve ratio is 15 percent, then for every ringgit that is deposited in the bank, the bank will _____.
    A. loan out 15 cents
    B. keep 15 cents as reserves
    C. keep 85 cents as reserves
    D. keep 15 cents as reserves and loan out 15 cents

14. When the central bank _____ securities in an open market operation, banks' reserves _____ and therefore lending _____.
    A. sells; increase; increases
    B. buys; increase; increases
    C. sells; decrease; increases
    D. buys; decrease; decreases

15. The _____ the required reserve ratio, the _____ the _____ in the quantity of money created from an initial increase of RM100,000 in deposit.
    A. larger; larger; decrease
    B. smaller; larger; increase
    C. larger; smaller; decrease
    D. smaller; larger; decrease

16. To fight recession, the central bank can _____.
    A. raise the interest rate by buying securities
    B. raise the interest rate by selling securities
    C. lower the interest rate by buying securities
    D. lower the interest rate by selling securities

17. Travis always carries RM100 in his wallet to pay for groceries. This is an example of the _____.
    A. wealth demand for money
    B. speculative demand for money
    C. transactions demand for money
    D. precautionary demand for money

18. If the interest rate increases, the _____.
    A. quantity of money demanded will fall
    B. money demand curve will shift to the left
    C. money demand curve will shift to the right
    D. quantity of money demanded will remain unchanged

19. Suppose in year 1 the CPI is 90, in year 2 the CPI is 100, and in year 3 the CPI is 110. Then, inflation rate is _____.
    A. 11 percent between years 1 and 2
    B. 11 percent between years 2 and 3
    C. 10 percent between years 2 and 3
    D. both A and C

Continued...

20. The menu cost of inflation involves _____.
    A. higher food prices
    B. cost-of-living adjustments
    C. the costs associated with changing price lists
    D. the mistake people make when they do not know the actual rate of inflation

21. If you negotiated a salary based on an anticipated inflation rate of 4 percent, and the actual inflation rate turned out to be 6 percent _____.
    A. your employer would have gained at your expense
    B. your real wage will increase, but your nominal wage will decrease
    C. the purchasing power of your real wages would be more than you anticipated
    D. the purchasing power of your wages will not change, since purchasing power is based on your nominal wage

22. Economists consider an economy to be at "full employment" when _____.
    A. there is no frictional unemployment
    B. there is no structural unemployment
    C. there is only a small amount of cyclical unemployment
    D. the unemployment rate equals the natural rate of unemployment

23. Part of the reason that economists are concerned about unemployment is that _____.
    A. unemployment reduces the size of the labour force
    B. unemployment always leads to frictional unemployment
    C. unemployment shifts the production possibilities curve outward
    D. the economy is producing less output than if there were full employment

24. A cutback in the space program due to a slow economy causes an increase in unemployment among aeronautical engineers. This is an example of _____.
    A. cyclical unemployment
    B. seasonal unemployment
    C. structural unemployment
    D. frictional unemployment

25. A rightward shift of the aggregate demand curve leads to _____.
    A. a leftward shift of the short-run Phillips curve
    B. a rightward shift of the short-run Phillips curve
    C. an upward movement along the short-run Phillips curve
    D. a downward movement along the short-run Phillips curve

26. The long-run Phillips curve shows the relationship between the inflation rate and the unemployment rate when the economy is _____.
    A. in expansion
    B. in recession
    C. at full inflation
    D. at full employment

Continued...

27. When countries specialise in producing goods in which they have a(n) _____ advantage, they minimise their combined output and allocate their resources _____ efficiently.
    A. absolute; more
    B. comparative; less
    C. comparative; more
    D. comparative; less

28. The price of a good that prevails in a world market is called the _____.
    A. world price
    B. relative price
    C. absolute price
    D. domestic price

29. Government payments made to domestic firms in order to encourage exports are called _____.
    A. tariffs
    B. bribes
    C. quotas
    D. subsidies

30. Thailand has a comparative advantage in rice and an absolute advantage in cell phones. Indonesia has a comparative advantage in cell phones and an absolute advantage in rice. According to this scenario, _____.
    A. Thailand should import both cell phones and rice
    B. Indonesia should export both cell phones and rice
    C. Thailand should export rice and import cell phones
    D. Indonesia should export rice and import cell phones

31. When a country allows trade and becomes an exporter of a good, _____.
    A. domestic producers gain and domestic consumers lose.
    B. domestic producers lose and domestic consumers gain.
    C. domestic producers and domestic consumers both gain.
    D. domestic producers and domestic consumers both lose.

32. Specialising in the production of a good or service in which one has a comparative advantage enables a country to do which of the following?
    A. never have to engage in trade with other nations
    B. increase the variety of products that it can produce with a decrease in resources
    C. produce a combination of goods that lies outside its production possibilities frontier
    D. consume a combination of goods that lies outside its production possibilities frontier

Continued...

33. When a U.S. company makes a $200,000 donation to the International Red Cross to help the victims of an earthquake in India, the transaction is recorded in the _____.
    A. capital account
    B. current account
    C. official settlements account
    D. international help account

34. Microsoft's purchase of a factory in Mexico is entered into the U.S. balance of payments accounts as a _____.
    A. positive entry in the capital account
    B. positive entry in the current account
    C. negative entry in the capital account
    D. negative entry in the current account

35. If Malaysia capital account balance has a RM30 million surplus and there was no change in official reserves during that year, we know that _____.
    A. Malaysia has a RM30 million current account deficit
    B. Malaysia has a RM30 million current account surplus
    C. Malaysia official reserves have increased by RM30 million
    D. none of the above

36. If the United States receives $200 billion of foreign investment and at the same time invests a total of $160 billion abroad, then the U.S. _____.
    A. current account must be in surplus
    B. capital account balance decreases by $40 billion
    C. capital account balance increases by $40 billion
    D. official settlements account balance increases by $40 billion

37. If a country sets a fixed exchange rate that is below the equilibrium exchange rate, how can the country maintain the fixed exchange rate?
    A. by decreasing the fixed exchange rate
    B. by selling surplus domestic currency at the fixed exchange rate
    C. by purchasing surplus domestic currency at the fixed exchange rate
    D. by purchasing surplus domestic currency at the equilibrium exchange rate

38. When the exchange rate between the U.S. dollar and the euro changes from 1.30 euros per dollar to 1.00 euro per dollar, the dollar has _____ and European goods have become _____ to people in the United States so that quantity of U.S. dollars supplied _____.
    A. depreciated; cheaper; increases
    B. depreciated; cheaper; decreases
    C. depreciated; more expensive; decreases
    D. appreciated; more expensive; decreases

Continued...

39. Everything else the same, in the foreign exchange market which of the following increases the demand for ringgit and shifts the demand curve rightward?
    A. Malaysia interest rate rises.
    B. Malaysia exchange rate falls.
    C. The Japanese interest rate rises.
    D. The expected future exchange rate falls.

Refer to ***Exhibit 1*** for questions no. 50.

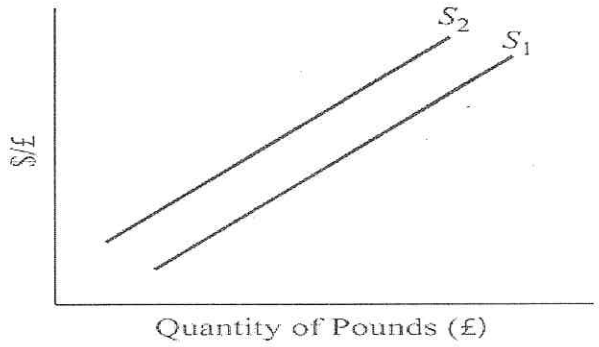

Exhibit 1

40. Refer to ***Exhibit 1***. Which of the following will shift the supply of pounds from S_1 to S_2?
    A. More British citizens travel to the United States.
    B. Fewer British firms want to invest in the United States.
    C. The price of U.S. bonds decreases relative to the price of British bonds.
    D. The inflation rate in the United States decreases relative to the inflation rate in England.

SECTION B: STRUCTURED QUESTIONS [60 MARKS]

Instructions: Answer **ALL** questions in this section.

QUESTION 1 (20 Marks)

Part A

Exhibit 2 depicts the initial balance sheet of Bank of Malaysia.

Bank of Malaysia

	RM		RM
Assets		**Liabilities**	
Reserves	200	Deposit	1,000
Loans	800		
	1,000		1,000

Exhibit 2

i. Based on the initial balance sheet, what is the required reserve ratio for Bank of Malaysia?

(2 marks)

ii. Assume that, Wilma Flinstone comes to the bank and deposits RM100. After Wilma's deposit, but before any other actions occur, calculate
   a) required reserves
   b) excess reserves

(5 marks)

iii. Show the new balance sheet after Wilma's deposit, assume that the bank holds no excess reserves.

(2 marks)

iv. Calculate the total increase in deposits in the banking system as a result of Wilma's deposit

(2 marks)

Part B

Exhibit 3 shows data on the demand for money.

Interest rate (percent per year)	Quantity of money demanded (billions of ringgit)
3	600
4	500
5	400
6	300

Exhibit 3

i. Assume that, initially, the equilibrium interest rate is 6%. What is the quantity of money demanded and money supplied?

(2 marks)

ii. If the central bank increases the supply of money by RM200 billion, what would happen to the equilibrium interest rate? Explain the adjustment process to the new equilibrium interest rate by using a diagram.

(7 marks)

[TOTAL 20 MARKS]

Continued...

QUESTION 2 (20 Marks)

Part A

Suppose Thailand allows trade in coal and the world price of coal is higher than the domestic price of coal in Thailand. Using a diagram, show Thailand's

i. consumer surplus before and after trade.
ii. producer surplus before and after trade.
iii. total surplus before and after trade

(7 marks)

Part B

Consider two countries, Vietnam and the China, each capable of producing coffee and wheat. Assume that for a given amount of inputs, the production possibilities for these two countries are as shown in *Exhibit 4*.

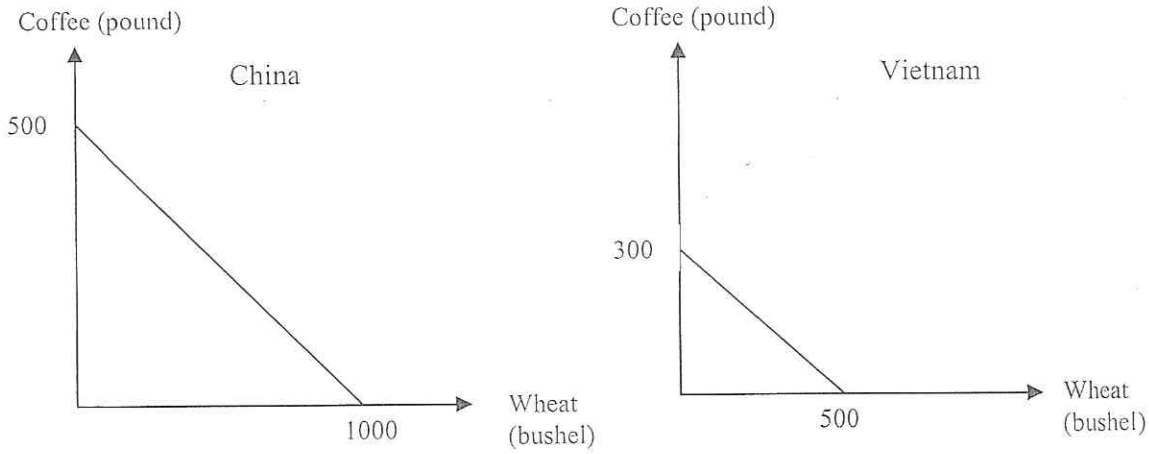

Exhibit 4

Based on *Exhibit 4*,

i) calculate the opportunity cost of producing coffee for each country.

(3 marks)

ii) calculate the opportunity cost of producing wheat for each country.

(3 marks)

iii) which country has a comparative advantage in producing wheat? Which country has a comparative advantage in producing coffee? Briefly explain.

(7 marks)

[TOTAL 20 MARKS]

Continued...

QUESTION 3 (20 Marks)

Part A

Assume ***Exhibit 5*** represents a country's balance of payments in a given year.

Items	(RM millions)
Merchandise exports	5,870
Balancing item	+40
Merchandise imports	4,360
Net inflow of interest, profits, dividends	1,500
Net services and transfers to abroad	380
Total investment and other capital outflows	180
Official borrowing from IMF	1,080

Exhibit 5

i. Based on ***Exhibit 5***, calculate

a) balance of trade. Is it a trade surplus or trade deficit? Briefly explain.

(2.5 marks)

b) current account balance.

(2 marks)

c) capital account balance.

(1 mark)

d) net change in international reserves.

(2 marks)

e) change in the official reserves of gold and foreign currency.

(1.5 marks)

ii. What is the difference between the current account balance and the merchandise trade balance?

(2 marks)

Part B

Exhibit 6 shows supply and demand schedules for euro in the foreign exchange market.

	RM per (euro)				
	RM0.20	RM0.25	RM0.30	RM0.35	RM0.40
Quantity demanded	500	400	300	200	100
Quantity supplied	100	200	300	400	500

Exhibit 6

Continued...

i. Graph the supply and demand curves for Euro.

(2 marks)

ii. Determine the equilibrium exchange rate.

(1 mark)

iii. Determine what would be the effect on demand and supply for Euro if there is an increase in Malaysia's real income, ceteris paribus. Determine what would happen to the equilibrium exchange rate. Would the ringgit appreciate or depreciate?

(3 marks)

iv. Suppose that now the exchange rate between Ringgit and Euro is fixed at RM0.35. Show this fixed exchange rate in the diagram drawn in part (a). Is Ringgit overvalued or undervalued? Determine what would be the effect of a fixed exchange rate at RM0.35 on Malaysia's balance of payments.

(3 marks)

[TOTAL 20 MARKS]

End of Paper